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PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Telecommunications Division **RESOLUTION T-16774**
Market Structure Branch **October 30, 2003**

R E S O L U T I O N

Resolution T-16774. Citizens Telecommunications Company of California, Inc. (U-1024-C). Order accepting subject to correction or adjustment as a result of future Commission Decisions, Citizens Telecommunications Company Of California, Inc's Annual Intrastate Shareable Earnings Advice Letter in Compliance with Decision 95-11-024.

By Advice Letter No. 792 Filed on April 7, 2003.

Summary

This Resolution accepts Citizens Telecommunications Company of California, Inc's (CTC) intrastate shareable earnings advice letter filing, subject to any corrections, adjustments or refunds that may be appropriate as a result of future Commission decisions or actions.

Background

New Regulatory Framework (NRF)

CTC began implementing its New Regulatory Framework (NRF) in January 1996 pursuant to Decision (D.) 95-11-024. D. 95-11-024 established a NRF program for CTC similar to that originally adopted for Pacific Bell (now SBC California) and GTEC (now Verizon California, Inc.) in D. 89-10-031. In D.89-10-031, the Commission replaced cost-of-service regulation for Pacific Bell and GTEC with incentive-based regulation known as NRF. NRF was centered around a price cap indexing mechanism, with sharing of excess earnings above a benchmark rate of return level. It is commonly known as a "price cap" model. The price cap model updates revenues yearly for inflation and expected productivity improvements for the telecommunications industry based on the formula:

$$R(t) = R(t-1) \times (1 + I-X) + \text{or} - Z$$

In this formula, is the rate to be set for the current year, R(t-1) is the rate in the prior year, I is inflation as measured by the gross national product price index (GNP-PI), X is productivity, and Z is other exogenous cost changes that are beyond the control of utility management and are subject to the Commission's review and approval.

Utilities under NRF were given an opportunity to earn a rate of return (ROR) above the traditional ROR used to establish a reasonable profit level to be included in the prices for utility services. The earnings sharing mechanism was adopted to provide a protection to ratepayers from an improperly functioning indexing mechanism. The sharing mechanism employs several ROR thresholds:

A market-based ROR (9.75%) is a ROR that reflects what a reasonable market driven ROR would be for a similarly situated utility with comparable risk.

A benchmark ROR (11.25%) that is higher than a traditional ROR to provide a strong incentive to the utility to operate more efficiently.

A cap (ceiling) ROR (14.75%) to protect ratepayers against the indexing mechanism that results in unreasonably high prices that result in excessive profit for the utility.

A floor ROR (6.5%) to provide a protection for shareholders in the event that indexing mechanism results in unreasonably low prices that result in earnings levels for the utility that are reasonably close to the market-based ROR.

Under the sharing mechanism, CTC retains 100% of its earnings up to the benchmark ROR, shares with ratepayers 50% of its earnings between the benchmark and cap RORs, and refunds to ratepayers 100% of its earnings above the cap ROR. CTC was required to file an advice letter reporting its intrastate earnings for each year to determine whether sharable earnings exist. The filing is required to be made no later than April 1 of the following year.

In D. 00-03-040 the Commission adopted a settlement between CTC and ORA that:

- continued the sharing mechanism,
- continued suspension of the inflation minus productivity (I-X) price cap formula, and
- eliminated most future Z-factor cost recovery, except for three on-going Z factor items.

On April 1, 2003, CTC filed Application 03-04-002 for its second triennial NRF review. In its application, CTC proposes modifications to the current NRF mechanism and its related parameters. ORA, in its protest to CTC's A. 03-04-002 recommended the Commission defer CPC's NRF review until after the adoption of the NRF review of SBC California and Verizon California, Inc.

CTC'S ANNUAL SHAREABLE EARNINGS FILING

Pursuant to D. 95-11-024, CTC filed its annual intrastate shareable earnings advice letter (AL), which is to be filed every April 1 for the purpose of reporting its actual rate of return for the preceding year and determining whether shareable earnings exist. The filing was made on a timely basis. CTC reported its intrastate ROR for year 2002 was 11.05% in AL 792 submitted on April 7, 2003. Other references reported in CTC's filing included the following rates of return:

Benchmark	11.25%
Ceiling	14.75%

Because CTC earnings is 2002 are below the sharing benchmark, CTC reports no sharing of earnings.

Notice/Protests

CTC states that a copy of the AL was mailed to competing and adjacent utilities and/or other utilities and interested parties as requested. Notice of AL 792 was published in the Commission Daily Calendar of April 9, 2003.

The Commission's Office of Ratepayer Advocates (ORA) filed a timely protest to AL 792 on April 29, 2003. ORA noted that it has been more than ten years since the Commission has conducted a Public Utilities Code Section 314.5 audit of CTC. In absence of such an audit, it is not possible for ORA to verify the accuracy of CTC's reported ROR. ORA noted that CTC's ROR is impacted by substantial cost allocations from it parent company and its affiliates. ORA recommended that the Commission commence a Section 314.5 audit immediately. ORA also recommended the Commission should only accept CTC's AL 792 subject to restatement, due to the fact that the results of a future audit may impact CTC's actual ROR for year 2002.

CTC filed a timely response to ORA's protest on May 7, 2003. CTC stated that the annual shareable earnings AL is merely a compliance filing. CTC objected to ORA raising the issue of an audit in the context of a yearly advice letter filing addressing shareable earnings. CTC's NRF review proceeding is a more appropriate forum to consider such issues. Since ORA identified no deficiency in AL 792, CTC believes the Commission should accept AL 792.

Discussion

We concur with ORA that CTC's ROR likely reflected substantial cost allocation from both the Parent Company and affiliates, and it is not possible to confirm the correctness of CTC's reported ROR based on review of CTC's workpaper. However, because no specific deficiency in CTC's AL has been identified at this time, we find no reason to reject CTC's reported ROR. In order to preserve the Commission's options, CTC's reported ROR will be accepted subject to any corrections, adjustments or refunds as a result of future Commission decisions or actions.

In accordance with P.U. Code Section 311 (g), TD mailed a copy of the original draft resolution on September 30, 2003 to interested parties. Comments received on a timely basis will be addressed in any final resolution.

Comments on DRAFT Resolution

The Telecommunications Division did not receive any comments on the DRAFT Resolution.

Findings

1) AL 792 was filed on April 7, 2003 while CTC was required to file the AL no later than April 1.

2) CTC reports its ROR for year 2002 was 11.05%.

3) Because CPT's reported ROR is below the sharing benchmark, there is no sharing of 2002 earnings with ratepayers.

4) Information contained in CTC's AL including the reported ROR have not been audited.

5) No deficiency in AL 792 has been identified at this time.

6) The reference RORs are as follows:

   - Market-Based: 9.75%
   - Benchmark: 11.25% (+ 150 basis points)
   - Ceiling: 14.75% (+ 500 basis points)

- Floor: 6.50% (- 325 basis points)

7) No comments were received on the DRAFT Resolution.

THEREFORE IT IS ORDERED THAT:

1. CTC's Annual Intrastate Earnings advice letter reporting its rate of return for the year 2002 shall be accepted subject to any corrections or adjustments that may be appropriate as a result of any future Commission decision.

This Resolution is effective today.

I hereby certify that this Resolution was adopted by the Public Utilities Commission at its regular meeting on October 30, 2003. The following Commissioners approved it:

WILLIAM AHERN
Executive Director